

**REPORT OF THE AUDIT OF THE
MORGAN COUNTY
FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2005**

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To the People of Kentucky
Honorable Ernie Fletcher, Governor
Robbie Rudolph, Secretary
Finance and Administration Cabinet
Honorable Tim Conley, Morgan County Judge/Executive
Members of the Morgan County Fiscal Court

Independent Auditors' Report

We have audited the accompanying financial statements of the governmental activities and each major fund of Morgan County, Kentucky, as of and for the year ended June 30, 2005, which collectively comprise the County's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Morgan County Fiscal Court. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Fiscal Court Audits issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, Morgan County, Kentucky, prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of Morgan County, Kentucky, as of June 30, 2005, and the respective changes in financial position thereof for the year then ended in conformity with the basis of accounting described in Note 1.

To the People of Kentucky
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The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated September 16, 2005 on our consideration of Morgan County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Respectfully submitted,


Morgan-Franklin, LLC

Audit fieldwork completed –
September 16, 2005

MORGAN COUNTY OFFICIALS

For The Fiscal Year Ended June 30, 2005

Fiscal Court Members:

Tim Conley	County Judge/Executive
Michael Gevedon	Magistrate
Denzil Potter	Magistrate
Frankie Spencer	Magistrate
Darris Smith	Magistrate
Darrell Patrick	Magistrate

Other Elected Officials:

Steve O'Connor	County Attorney
Gary Cox	Jailer
Randy Williams	County Clerk
Donna Pelfrey	Circuit Court Clerk
Mickey Whitt	Sheriff
Darrell Bradley	Property Valuation Administrator
Marling Potter	Coroner

Appointed Personnel:

Tommy Phipps	County Treasurer
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Morgan County, Kentucky
Management's Discussion and Analysis
For the Year Ended June 30, 2005
Unaudited

The discussion and analysis of Morgan County's financial performance provides an overview of the County's financial activities for the fiscal year ended June 30, 2005. The intent of this discussion and analysis is to look at the County's financial performance as a whole.

Financial Highlights

Key financial highlights for 2005 are as follows:

The County's total net assets increased by \$440 thousand, which represents a 3.08% increase from 2004. The net asset value of equipment and vehicles increasing by \$139 thousand and the net asset value of bridges increasing by \$230 thousand were major components of the increase in overall net assets.

The County's long term liabilities decreased \$224 thousand, which is reflective of the County's normal scheduled debt principal payments.

At the end of the current fiscal year, the County's combined fund cash balance was \$1,011 thousand, a decrease of \$345 thousand or 25% from the prior year. Of the \$1,011 thousand carry over \$580 thousand is allocated to specific projects which are incorporated into the County's fiscal year 2006 budget.

Overview of the Financial Statements

This annual report consists of a series of financial statements. These statements are organized so the reader can understand the County as a financial whole or as an entire operating entity. The statements also provide a detailed look at specific financial conditions.

The County's basic financial statements are comprised of three components: the County's financial statements, fund financial statements, and notes to the financial statements. This report also contains other supplementary information in addition to basic financial statements themselves.

County's Financial Statements

The County's financial statements are designed to provide readers with a broad overview of the County's finances, in a manner similar to a private-sector business.

Statement of Net Assets and Statement of Activities

The statement of net assets presents information on all of the County's assets and liabilities, with the difference between the two reported as net assets. The statement of activities presents information showing how the County's net assets changed during the current year. These statements are prepared using the modified cash basis of accounting similar to the accounting method used by private sector companies. This basis of accounting takes into consideration all of the current year's revenues and expenses when the cash is received or paid.

The change in net assets is important because it tells the reader whether, for the County as a whole, the financial position of the County has improved or diminished. However, in evaluating the overall position of the County, nonfinancial information such as changes in the County's tax base and the condition of the County's capital assets will also need to be evaluated.

In the statement of net assets and the statement of activities, the County is divided into several major expenditure categories:

Expenditure Category
General Government
Protection to Persons & Property
Health and Sanitation
Social Services
Recreation and Culture
Roads
Debt Service
Capital Projects
Administration

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objects. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. Fund financial statements provide detail information about the County's major funds. Based on the restriction on the use of moneys as set forth in the County's annual budget, the County has established many funds that account for the multitude of services provided to our citizens. The County's major governmental funds are the general fund, road fund, jail fund, local government economic assistance fund and timberland-taxing fund.

Governmental Funds – Governmental funds are used to account for essentially the same functions reported as governmental activities on the government wide financial statements. Most of the County's basic services are reported in these funds that focus on how money flows into and out of the funds and the year-end balances available for spending. These funds are reported on a modified cash basis of accounting meaning that all revenues are recognized when received all expenditures recognized when paid. The governmental funds statements provide a detailed short-term view of the County's general governmental operations and the basic services being provided, along with the financial resources available.

Because of the focus of the governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities on the government wide financial statements. By doing so, readers may better understand the long-term effect of the government's short term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The County maintains several individual governmental funds. Information is presented separately on the governmental fund balance sheet and on the governmental fund statement of revenues,

expenditures and changes in fund balances for the major funds, which were identified earlier. Data from the other governmental funds are combined into a single aggregate presentation.

Notes to the financial statements – The notes provide additional information that is essential to a full understanding of the data provided on the government wide and fund financial statements.

Other information – In addition to the basic financial statements and accompanying notes, this report also presents combined and individual fund statements and schedules.

Government Wide Financial Analysis

Table 1 provides a summary of the County's net assets for 2005 compared to 2004 as well as the changes in net assets for 2005:

MORGAN COUNTY FISCAL COURT Balance Sheet Comparison FY 2004 and FY 2005				
Assets:	FY 2004	FY 2005	\$ Difference	% Difference
Total Fund Cash Balance	1,356,360.63	988,396.37	(367,964.26)	-27.13%
KACO Leasing Trust Account Balance		22,810.00	22,810.00	
Total Capital Assets	18,896,258.51	19,502,760.70	606,502.18	3.21%
Total Assets	20,252,619.14	20,513,967.07	261,347.92	1.29%
Liabilities:				
Current & Other Liabilities	313,511.00	358,922.00	45,411.00	14.48%
Long Term Liabilities	5,647,642.00	5,423,754.00	(223,888.00)	-3.96%
Total Liabilities	5,961,153.00	5,782,676.00	(178,477.00)	-2.99%
Total Net Assets	14,291,466.14	14,731,291.07	439,824.92	3.08%

As noted earlier, the County's net assets, when reviewed over time, may serve as a useful indicator of the County's financial position. In the case of the County, assets exceeded liabilities by \$14,731 thousand as of June 30, 2005 and \$14,291 thousand as of June 30, 2004 an increase of \$440 thousand or 3.08%. The largest component of the County's assets is capital assets at \$19,503 thousand or 95% of total assets. These assets represent investment in land, buildings, roads, road improvements, bridges, land improvements, vehicles, and equipment. These assets are used to provide services to the citizens of the county and consequently these assets are not available for future spending. Related to the capital assets are long-term liabilities in the amount of \$5,856 thousand. Net of the related debt the County's capital assets would be \$13,720 thousand. It should be noted that the resources needed to repay the debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities. At year end \$580 thousand of net assets or 3.84% of the County's total net assets are restricted to specific capital projects and other general governmental activities.

The changes in total cash funds for 2005 are detailed in the cash flow analysis table. Total net assets increased \$440 thousand or 3.08% over the previous year. Fund cash balances decreased \$345 thousand over the previous year with net capital assets increasing \$607 thousand.

Cash Flow Analysis

The following table analyzes the net changes in cash for fiscal year 2004 and fiscal year 2005.

MORGAN COUNTY FISCAL COURT		
Change in Cash Comparison FY 2004 and FY 2005		
	FY 2004	FY 2005
Revenues:		
Property Taxes	226,520.30	221,895.79
Other Taxes	253,503.02	284,999.36
Excess Fees	23,676.14	28,345.68
Federal Grants	223,228.49	184,683.79
State Grants	1,582,470.03	1,428,447.00
Intergovernmental	1,843,965.60	2,412,371.54
Interest	87,678.50	60,979.97
Other	147,150.84	154,480.05
Total Revenue	4,388,192.92	4,776,203.18
Transfers	-	-
Expenditures:		
General Government	596,825.84	574,022.08
Protection to Persons & Property	490,607.17	406,268.68
Health & Sanitation	169,531.66	132,607.67
Social Services	-	-
Recreation & Culture	3,160.00	3,160.00
Airports	509.50	602.00
Roads	907,527.09	1,153,893.46
Capitol Projects	2,212,631.70	1,797,303.28
General Services	59,874.98	49,102.07
Debt Service	542,250.77	579,707.84
Administration	343,537.55	440,804.34
Distributions to Other Gov't Agencies	6,510.61	6,696.02
Total Expenditures	5,332,966.87	5,144,167.44
Increase (Decrease) In Net Cash	(944,773.95)	(367,964.26)
Cash Balance Beginning of Year	2,301,134.58	1,356,360.63
Cash Balance End of Year	1,356,360.63	988,396.37

For fiscal year 2004 the County's cash reserves decreased by \$945 thousand and for fiscal year 2005 the County's cash reserves decreased by \$368 thousand. Total revenues increased \$388 thousand from 2004 to 2005 attributed mostly to the increase in intergovernmental revenue of \$568 thousand but were offset by a decrease in state grants by \$154 thousand.

Total expenditures decreased by \$189 thousand from 2004 to 2005 driven by decreases in several categories. Expenditures on roads increased \$246 thousand for the year due largely to paving projects for \$402 thousand and roadway improvement projects for \$267 thousand.

Intergovernmental revenues increased by \$568 thousand during the year in part due to funds from transportation grants from the State of \$434 thousand for paving and bridge projects as well as \$170 thousand of coal production funds from the state.

The following table analyzes the change in fund balance by fund for 2005:

MORGAN COUNTY FISCAL COURT						
Statement of Revenues Expenditures and Change in Fund Balance 2005						
	General Fund	Road Fund	Jail Fund	LGEA Fund	Timberland Taxing Fund	Totals
Fund Balance Beginning of Year	1,180,096.56	170,507.23	5,626.22	-	130.62	1,356,360.63
Revenue Receipts	2,561,456.75	1,884,304.72	91,942.71	235,480.42	3,018.58	4,776,203.18
Interfund Transfers In	91,108.54	52,121.88	222,250.00	-		365,480.42
Interfund Transfers (Out)	130,000.00	-		235,480.42		365,480.42
General Government Expenditures	574,022.07	-				574,022.07
Protection to Persons & Property Expenditures	107,883.94	-	295,235.54		3,149.20	406,268.68
General Health & Sanitation Expenditures	132,607.67	-				132,607.67
Airport Expenditures	602.00	-				602.00
Roads & Transportation Expenditures	-	1,153,893.46				1,153,893.46
Capital Project Expenditures	1,536,839.29	260,464.00				1,797,303.29
Recreation & Culture Expenditures	3,160.00	-				3,160.00
Debt Service Expenditures	239,611.06	340,096.78				579,707.84
Financial Administration Expenditures	294,823.87	182,409.65	19,368.91			496,602.43
Fund Balance End of Year	813,111.95	170,069.94	5,214.48	-	-	988,396.37
Change in Fund Balance	(366,984.61)	(437.29)	(411.74)	-	(130.62)	(367,964.26)

The decrease in fund balance of \$368 thousand is largely due to the general fund decrease in fund balance of \$367 thousand. The general fund decrease represents 99.7% of the overall fund balance decrease for the year.

Budgetary Highlights

By statute, the fiscal court adopts an annual operating budget for the County before the first day of each new fiscal year. The budget is reviewed as to form classification and content by the Governor's Office for Local Development in Frankfort prior to final adoption by the County. As necessary the budget is amended by the County through an ordinance process to include unanticipated revenues, distributing those revenues to various appropriation line items or placing unanticipated revenues in reserve accounts. The fiscal court makes line item appropriation transfers throughout the fiscal year to keep appropriation line items properly funded.

Current & Other Liabilities

The \$22 thousand reserve for encumbrances in the governmental funds for 2004 and \$23 thousand for 2005 represent the respective amounts of current unpaid bills held by the County at year-end. The vast majority of bills are paid subsequent to each meeting of the Fiscal Court, which meets the second Wednesday of each month. Therefore, at the end of any month throughout the year the County will have varying amounts of bills unpaid. These unpaid bills are also reported with the County's quarterly financial reports to the Governor's Office for Local Development.

Long Term Debt

The County has assumed a certain level of long term debt to finance activities such as building construction, road surfacing, road equipment and vehicles. The Kentucky Association of Counties Leasing Trust in Frankfort provides this long term financing to the County. At the end of 2004 the level of long term debt was \$5,961 thousand and at the end of 2005 was \$5,856 thousand. Details of the County's long term debt follow:

Description	Year End Balance	Rate of Interest	Maturity Date
Road Blacktop Projects	\$2,024,633	2.95%	06/28/2020
Road Blacktop Projects	\$1,299,642	2.95%	12/01/2020
Morgan Co. Library	\$1,903,802	4.64%	01/20/2021
Ambulance & Sheriff's Cars	\$43,000	4.13%	02/20/2007
Road Equipment	\$340,000	3.15%	01/20/2011
Vehicle & Mowing Equipment	\$171,599	2.95%	05/20/2009
Total	\$5,782,676		

During the year the County paid \$357 thousand on principal reduction and \$223 thousand in interest payments. The County incurred \$252 thousand of new debt during the year for new road equipment (\$175 thousand) and a new ambulance (\$77 thousand).

Concerning the debt for the Morgan Co. Library, the County receives an annual grant of \$183 thousand from the State, which is used to fund the debt service for the Library.

The Morgan County Ambulance Taxing District provides funds equal to the amount of the debt service for the ambulance. The ambulance is titled in the Morgan County Ambulance Taxing District's name.

Capital Assets

An analysis of the changes in the County's capital assets is shown in the table below:

MORGAN COUNTY FISCAL COURT			
Analysis of Capital Assets for 2004 and 2005			
	2004	2005	Difference
Bridges			
Depreciable Cost	2,225,527	2,491,990	266,463
Accumulated Depreciation	(266,657)	(303,608)	(36,951)
Net Value of Bridges	1,958,870	2,188,382	229,512
Paved Roads			
Depreciable Cost	6,326,089	6,728,627	402,538
Accumulated Depreciation	(1,672,093)	(2,005,299)	(333,205)
Net Value of Paved Roads	4,653,995	4,723,328	69,333
Road Projects			
Depreciable Cost	67,363	67,363	-
Accumulated Depreciation	(1,336)	(2,851)	(1,515)
Net Value of Road Projects	66,027	64,512	(1,515)
Land			
Cost	2,222,164	2,222,164	-
Net Value of Land	2,222,164	2,222,164	-
Equipment & Vehicles			
Depreciable Cost	806,340	1,052,755	246,415
Accumulated Depreciation	(98,009)	(205,885)	(107,876)
Net Value of Equipment & Vehicles	708,331	846,870	138,539
Land Improvements			
Depreciable Cost	1,719,477	1,729,331	9,853
Accumulated Depreciation	(244,792)	(282,877)	(38,085)
Net Value of Land Improvements	1,474,686	1,446,454	(28,232)
Buildings			
Depreciable Cost	9,328,630	9,353,008	24,378
Accumulated Depreciation	(1,552,391)	(1,763,808)	(211,417)
Net Value of Buildings	7,776,239	7,589,200	(187,039)
Furnishings	-		
Depreciable Cost	-	28,264	28,264
Accumulated Depreciation	-	(1,626)	(1,626)
Net Value of Furnishings	-	26,638	26,639
Construction In Progress			
Current Cost	35,947	395,212	359,266
Total Cost	22,731,535	24,068,713	977,911
Total Accumulated Depreciation	(3,835,278)	(4,565,952)	(730,675)
Net Value	18,896,259	19,502,761	606,502

The total depreciable cost increased by \$978 for 2005 an increase of 4.31%. Nearly all categories of assets increased during 2005 including bridges \$266 thousand, paved roads \$403 thousand, equipment and vehicles \$246 thousand. Construction in progress increased by \$359 thousand, which represents expenditures on the community center pool project, which is nearing completion. Accumulated depreciation increased by \$731 thousand for the year. Net capital asset values increased by \$607 thousand for the year.

Depreciation is taken on a straight-line basis for all capital assets except land, which is not depreciated. Depending upon the class of asset, depreciation is taken over various assets lives with varying amounts of salvage value attributed to the various classes of assets at the end of their useful lives. As an example buildings have a useful life of 40 years generally speaking with a 10% of original cost as a salvage value.

Requests for Information

This financial report is designed to provide a general overview of the County's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Morgan County Judge/Executive, 450 Prestonsburg Street, West Liberty, KY 41472.

MORGAN COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2005

MORGAN COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS
JUNE 30, 2005

	<u>Primary Government</u> <u>Governmental</u> <u>Activities</u>
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 988,397
KACO Leasing Trust Account	22,810
Total Current Assets	<u>\$ 1,011,207</u>
Noncurrent Assets:	
Capital Assets - Net of Accumulated	
Depreciation:	
Construction In Progress	\$ 395,212
Land and Land Improvements	3,668,593
Buildings	7,589,059
Furnishings	26,638
Vehicles and Equipment	846,803
Infrastructure Assets - Net of Depreciation	6,975,979
Total Noncurrent Assets	<u>\$ 19,502,284</u>
Total Assets	<u>\$ 20,513,491</u>
LIABILITIES	
Current Liabilities:	
Financing Obligations	358,922
Noncurrent Liabilities:	
Financing Obligations	<u>\$ 5,423,754</u>
Total Liabilities	<u>\$ 5,782,676</u>
NET ASSETS	
Invested In Capital Assets, Net of Related Debt	\$ 13,719,608
Restricted	579,927
Unrestricted	431,280
Total Net Assets	<u><u>\$ 14,730,815</u></u>

The accompanying notes are an integral part of the financial statements.

**MORGAN COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS**

For The Year Ended June 30, 2005

MORGAN COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2005

Functions/Programs	Expenses	Program Revenues Received			Net (Disbursements) Receipts and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Governmental Activities
Primary Government:					
Governmental Activities:					
General Government	\$ 1,115,435	\$ 698	\$ 90,175	\$ 6,705	\$ (1,017,857)
Protection to Persons and Property	437,241	47,358	73,259		(316,624)
General Health and Sanitation	170,529		34,020		(136,509)
Recreation and Culture	41,391				(41,391)
Roads	1,153,737	117,500	438,604	1,439,829	842,196
Road Facilities	20,115		82,509	0	62,394
Debt Service	226,230	27,526		183,250	(15,454)
Capital Projects	1,172,178			1,382,672	210,494
Total Governmental Activities	<u>\$ 4,336,856</u>	<u>\$ 193,082</u>	<u>\$ 718,567</u>	<u>\$ 3,012,456</u>	<u>\$ (412,751)</u>
Total Primary Government	<u>\$ 4,336,856</u>	<u>\$ 193,082</u>	<u>\$ 718,567</u>	<u>\$ 3,012,456</u>	<u>\$ (412,751)</u>
General Revenues:					
Taxes					
Real Estate Taxes					\$ 107,127
Tangible Personal Property Tax					11,856
Motor Vehicle Taxes					50,154
Delinquent Property Taxes					7,882
Franchise Fees					44,877
Other Taxes					334,149
In Lieu Tax Payments					41,434
Excess Fees					28,346
Miscellaneous Revenues					165,295
Interest Earned					60,980
Total General Revenues					<u>\$ 852,100</u>
Change in Net Assets					<u>\$ 439,349</u>
Net Assets - Beginning					<u>\$ 14,291,466</u>
Net Assets - Ending					<u>\$ 14,730,815</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2005

MORGAN COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
June 30, 2005

	General Fund	Road Fund	Jail Fund	Local Government Economic Assistance Fund	Forestry Fund	Total Governmental Funds
ASSETS						
Cash and Cash Equivalents	\$ 813,112	\$ 192,880	\$ 5,215	\$ 0	\$ 0	\$ 1,011,207
TOTAL ASSETS	<u>\$ 813,112</u>	<u>\$ 192,880</u>	<u>\$ 5,215</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,011,207</u>
FUND BALANCES						
Fund Balances:						
Restricted:						
Capital Projects	\$ 58,184	\$	\$	\$	\$	\$ 58,184
AG Development	398,575					398,575
Other Purposes	100,358					100,358
Reserved For Encumbrances	17,412	5,524	212			23,148
Unreserved	238,583	187,356	5,003			430,942
TOTAL FUND BALANCES	<u>\$ 813,112</u>	<u>\$ 192,880</u>	<u>\$ 5,215</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,011,207</u>

Reconciliation to Statement of Changes in Net Assets:

Total Governmental Fund Balances	\$ 1,011,207
Amounts Reported for Governmental Activities in the Statement of Net Assets are Different because:	
Capital Assets Used in Governmental Activities of \$23,673,498, net of accumulated depreciation of \$4,566,426, are not financial resources and, therefore, are not reported in the funds.	19,107,072
Construction In Progress	395,212
Liabilities:	
Due Within One Year - Lease Principal Payments	(358,922)
Due In More Than One Year - Lease Principal Payments	(5,423,754)
Net Assets of Governmental Activities	<u>\$ 14,730,815</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES – GOVERNMENTAL FUNDS – MODIFIED CASH BASIS

For The Year Ended June 30, 2005

MORGAN COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
For The Year Ended June 30, 2005

	General Fund	Road Fund	Jail Fund	Local Government Economic Assistance Fund	Forestry Funds	Total Governmental Funds
REVENUES						
Taxes	\$ 553,040	\$	\$	\$	\$ 3,005	\$ 556,045
In Lieu Tax Payments	28,042	13,392				41,434
Excess Fees	28,346					28,346
Intergovernmental	1,725,883	1,726,470	46,261	234,472		3,733,086
Charges for Services		117,500	45,334			162,834
Miscellaneous		23,136	255			193,481
Interest	170,090	3,810	93	1,008	14	60,980
Total Revenues	\$ 2,561,456	\$ 1,884,308	\$ 91,943	\$ 235,480	\$ 3,019	\$ 4,776,206
EXPENDITURES						
General Government	\$ 574,023	\$	\$	\$	\$	\$ 574,023
Protection to Persons and Property	107,884		295,235		3,149	406,268
General Health and Sanitation	132,608					132,608
Recreation and Culture	3,160					3,160
Roads		1,285,969				1,285,969
Road Facilities		20,115				20,115
Debt Service:						
Principle	129,324	227,178				356,502
Interest	110,287	112,919				223,206
Capital Projects	1,537,441	260,464				1,797,905
Administration	294,823	182,411	19,369			496,603
Total Expenditures	\$ 2,889,550	\$ 2,089,056	\$ 314,604	\$ 0	\$ 3,149	\$ 5,296,359
Excess (Deficiency) of Revenues over Expenditures Before Transfers and Financing Sources (Uses)	\$ (328,094)	\$ (204,748)	\$ (222,661)	\$ 235,480	\$ (130)	\$ (520,153)
OTHER FINANCING SOURCES (USES)						
Lease Proceeds	\$ 0	\$ 175,000	\$ 0	\$ 0	\$ 0	\$ 175,000
Transfers from Other Funds	91,109	52,121	222,250			365,480
Transfers to Other Funds	(130,000)			(235,480)		(365,480)
Total Other Financial Sources (Uses)	\$ (38,891)	\$ 227,121	\$ 222,250	\$ (235,480)	\$ 0	\$ 175,000
Net Change In Fund Balances	\$ (366,985)	\$ 22,373	\$ (411)	\$ 0	\$ (130)	\$ (345,153)
Fund Balances, Beginning	1,180,097	170,507	5,626	0	130	1,356,360
Fund Balances, Ending	\$ 813,112	\$ 192,880	\$ 5,215	\$ 0	\$ 0	\$ 1,011,207

The accompanying notes are an integral part of the financial statements.

**MORGAN COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
MODIFIED CASH BASIS**

For The Year Ended June 30, 2005

MORGAN COUNTY
 RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
 CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
 STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
 For The Year Ended June 30, 2005

Reconciliation to the Statement of Activities:

Net Change in Fund Balances-Total Governmental Funds	\$ (345,153)
Governmental Funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:	
Capital Outlay	1,337,175
Depreciation Expense	(731,150)
The issuance of long-term debt provides current financial resources to governmental funds. These transactions, however, have no effect on net assets:	
Lease Proceeds	(175,000)
Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets:	
Capital Debt Obligation Principal Payments	<u>353,477</u>
Change in Net Assets of Governmental Activities	<u>\$ 439,349</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

The county presents its government wide and fund financial statements utilizing a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transactions, with a few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Property tax receivables, accounts payable, compensated absences, and donated assets, among other items are not reflected in the financial statements.

Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however encumbrances are reflected on the Balance Sheet – Governmental Funds as part of the fund balance (Reserved for Encumbrances).

The State Local Finance Officer does not require the county to report capital assets and infrastructure; however the value of these assets are included in the Statement of Net Assets and their corresponding depreciation expense is included on the Statement of Activities.

B. Reporting Entity

The financial statements of Morgan County include the funds, agencies, boards, and entities for which the fiscal court is financially accountable. Financial accountability, as defined by Section 2100 of the Governmental Auditing Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14 and GASB 39, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Consequently, the reporting entity includes organizations that are legally separate from the primary government. Legally separate organizations are reported as component units if either the county is financially accountable or the organization's exclusion would cause the county's financial statements to be misleading or incomplete. Component units may be blended or discretely presented. Blended component units either provide their services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as the primary government. All other component units are discretely presented. Based upon the application of the criteria stated in GASB 14, there are no component units which merit consideration as part of the reporting entity.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies (Continued)

C. Morgan County Constitutional Elected Officials

Kentucky law provides for election of the below officials from the geographic area constituting Morgan County. Pursuant to state statute, these officials perform various services for the Commonwealth of Kentucky, its judicial courts, the fiscal court, various cities and special districts within the county, and the board of education. In exercising these responsibilities, however, they are required to comply with state laws. Audits of their financial statements are issued separately and individually and can be obtained from their respective administrative offices. These financial statements are not required to be included in the financial statements of Morgan County, Kentucky.

Circuit Court Clerk
County Attorney
Property Valuation Administrator
County Clerk
County Sheriff

D. Property Tax Calendar

Generally, and accept as otherwise provided by law, property taxes are assessed as of January 1, levied (mailed) November 1, due at discount November 30, due at face value December 31, delinquent January 1 following the assessment, and subject to lien and sale the 3rd Saturday in April following the delinquency date

E. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government and its non-fiduciary component units. For the most part, the effect of interfund activities has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on sales, fees, and charges for support. Business-type revenues come mostly from fees charged to external parties for goods or services. Fiduciary funds are not included in these financial statements due to the unavailability of fiduciary funds to aid in the support of government programs.

The statement of net assets presents the reporting entity's non-fiduciary assets and liabilities, the difference between the two is being reported as net assets. Net assets are reported in three categories: 1) invested in capital assets, related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets; 2) restricted net assets - resulting from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; 3) unrestricted net assets - those assets that do not meet the definition of restricted net assets or invested in capital assets.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies (Continued)

E. Government-Wide and Fund Financial Statements (Continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function 2) operating grants and contributions and 3) capital grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Internally dedicated resources such as taxes and unrestricted state funds are reported as general revenues.

Funds are characterized as either major or non-major funds. Major funds are those funds whose assets, liabilities, revenues, or expenditures/expenses are at least ten percent of the corresponding total (assets, liabilities, etc.) for all funds or type (governmental or proprietary funds) and whose total assets, liabilities, revenues, and expenditures/expenses are at least five percent of the corresponding total for all governmental and enterprise funds combined. The fiscal court may also designate any fund as a major fund.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds. Major individual governmental funds and major enterprise funds are reported as separate columns in the financial statements.

Governmental Funds

All governmental fund statements are reported using the current financial resources measurement focus and the modified cash basis of accounting. The modified cash basis recognizes revenues when received and expenditures when paid. Property tax receivables, accounts payable, compensated absences, and donated assets are not reflected in the financial statements.

The primary government reports the following major governmental funds:

General Fund - This is the primary operating fund of the fiscal court. It accounts for all financial resources of the general government, except where the Governor's Office for Local Development requires a separate fund or where management requires that a separate fund be used for some function.

Road Fund - This fund is for road and bridge construction and repair. The primary source of revenue for this fund is state payments for truck licenses distribution, municipal road aid, and transportation grants. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

Jail Fund - The primary purpose of this fund is to account for the jail expenses of the county. The primary sources of revenue for this fund are reimbursements from the state and federal government, payments from other counties for housing prisoners, and transfers from the General Fund. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies (Continued)

E. Government-Wide and Fund Financial Statements (Continued)

Local Government Economic Assistance Fund – These funds may be spent for public safety, environmental protection, public transportation, health, recreation, libraries, social services, industrial and economic development, workforce training, and secondary wood industry development. In no event shall these funds be used for expenses relating to the administration of government. The Governor's Office for Local Development requires the Fiscal Court to maintain these receipts and expenditures separately from the General Fund.

Forestry Fund – The primary purpose of this fund is to account for funds received from timberland taxes.

Management has determined all funds to be major funds; therefore, there are no non-major funds.

Special Revenue Funds

The Road Fund, Jail Fund, Local Government Economic Assistance Fund, and Forestry Fund are presented as Special Revenue Funds. Special Revenue Funds are to account for the proceeds of specific revenue sources and expenditures that are legally restricted for a specific purpose.

F. Deposits and Investments

The government's cash and cash equivalents are considered to be cash on hand, demand deposits, certificate of deposits, and short-term investments with original maturities of three months or less from the date of acquisition. KRS 66.480 authorizes the county to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

G. Capital Assets

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, equipment, and infrastructure assets (roads and bridges) that have a useful life of more than one reporting period based on the government's capitalization policy, are reported in the applicable governmental activities of the government-wide financial statements. Such assets are recorded at acquisition or construction cost or estimated historical cost when purchased or constructed.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies (Continued)

G. Capital Assets (Continued)

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction In Progress are not depreciated. Interest incurred during construction is not capitalized. Capital assets and infrastructure are depreciated using the straight-line method of depreciation over the estimated useful life of the asset.

Capitalization	Useful Life	Threshold	(Years)
Land Improvements		\$ 25,000	10-60
Buildings and Building Improvements		25,000	10-75
Machinery and Equipment		2,500	3-25
Vehicles		2,500	5 - 7
Infrastructure		20,000	2-40

H. Long-term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long term debt and other long-term obligations are reported as liabilities in the applicable financial statements. The principal amount of bonds, notes and financing obligations are reported.

In the fund financial statements, governmental fund types recognize bond interest, as well as bond issuance cost when received or when paid, during the current period. The principal amount of the debt and interest is reported as expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures. Debt proceeds received are reported as other financing sources.

I. Fund Equity

In the fund financial statements, the difference between the assets and liabilities of governmental funds is reported as fund balance. Fund balance is divided into reserved and unreserved components, with unreserved considered available for new spending. Unreserved fund balances, may be divided into designated and undesignated portions. Designations represent fiscal court's intended use of the resources and should reflect actual plans approved by the fiscal court.

Governmental funds report reservations of fund balance for amounts that are legally restricted by outside parties for use for a specific purpose, long-term receivables, and encumbrances. "Reserved for Encumbrances" are purchase orders that will be fulfilled in a subsequent fiscal period. Although the purchase order or contract creates a legal commitment, the fiscal court incurs no liability until performance has occurred on the part of the party with whom the fiscal court has entered into the arrangement. When a government intends to honor outstanding commitments in subsequent periods, such amounts are encumbered. Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however, encumbrances are reflected on the Balance Sheet - Governmental Funds as part of the fund balance.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies (Continued)

J. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

K. Jointly Governed Organizations

A jointly governed organization is an entity that results from a multigovernmental arrangement that is governed by representatives from each participating government. The entity provides services to the citizens of each participating government, but there is no ongoing financial interest or responsibility by the participating government. The jointly governed organization can act independently of each of the participating governments. The Menifee, Morgan, and Rowan Counties Industrial Park (MMRC) meets the criteria noted above and is an organization jointly governed by the Kentucky counties previously mentioned.

Note 2. Deposits

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) in accordance with KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the county's deposits may not be returned to it. The county does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240(4). As of June 30, 2005, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 3. Operating Lease

Liabilities of the Road Fund are:

<u>Description</u>	<u>Purchase Date</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Amount</u>
2003 GMC Yukon	05/20/2003	04/20/2008	9.95%	\$18,062

Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2006	\$ 1,471	\$ 5,828
2007	890	6,409
2008	257	5,825
Totals	<u>\$ 2,618</u>	<u>\$ 18,062</u>

Note 4. Capital Assets

Depreciation expense was charged to functions of the primary government as follows:

General Government	\$ 164,832
Protection to Persons and Property	55,351
General Health and Sanitation	37,921
Recreation and Culture	38,231
Roads	<u>434,815</u>
Total Depreciation Expense – Governmental Activities	<u>\$ 731,150</u>

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 4. Capital Assets

Capital assets activity for the year ended June 30, 2005 was as follows:

	Reporting Entity			Ending Balance
	Beginning Balance	Increases	Decreases	
Primary Government:				
<u>Governmental Activities:</u>				
Capital Assets Not Being Depreciated:				
Land	\$ 2,222,164	\$ 0	\$ 0	\$ 2,222,164
Construction In Progress	35,947	359,265		395,212
Total Capital Assets Not Being Depreciated	<u>\$ 2,258,111</u>	<u>\$ 359,265</u>	<u>\$ 0</u>	<u>\$ 2,617,376</u>
Capital Assets, Being Depreciated:				
Land Improvements	\$ 1,719,478	\$ 9,853	\$ 0	1,729,331
Buildings	9,328,627	24,378		9,353,005
Furnishings	0	28,264		28,264
Equipment and Vehicles	806,340	246,415		1,052,755
Infrastructure	8,618,978	669,001		9,287,979
Total Capital Assets Being Depreciated	<u>\$ 20,473,423</u>	<u>\$ 977,911</u>	<u>\$ 0</u>	<u>\$ 21,451,334</u>
Less Accumulated Depreciation For:				
Land Improvements	244,792	38,110		282,902
Buildings	1,552,391	211,555		1,763,946
Furnishings		1,626		1,626
Equipment and Vehicles	98,009	107,943		205,952
Infrastructure	1,940,084	371,916		2,312,000
Total Accumulated Depreciation	<u>\$ 3,835,276</u>	<u>\$ 731,150</u>	<u>\$ 0</u>	<u>\$ 4,566,426</u>
Total Capital Assets, Being Depreciated, Net	<u>\$ 16,638,147</u>	<u>\$ 246,761</u>	<u>\$ 0</u>	<u>\$ 16,884,908</u>
Governmental Activities Capital Assets, Net	<u>\$ 18,896,258</u>	<u>\$ 606,026</u>	<u>\$ 0</u>	<u>\$ 19,502,284</u>

See Accompanying Auditors' Report

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 5. Long-term Debt

- A. On June 27, 2000, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$2,500,000 for road improvements on certain designated county roads. The agreement requires variable monthly payments for 240 months to be paid in full November 20, 2022. The principal balance of the agreement was \$2,024,633 as of June 30, 2005. Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2006	\$ 80,048	\$ 107,355
2007	75,674	111,729
2008	71,100	116,281
2009	66,325	121,019
2010	61,454	125,949
2011-2015	225,984	711,008
2016-2020	70,063	731,292
Totals	<u>\$ 650,648</u>	<u>\$ 2,024,633</u>

- B. On December 20, 2001, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$1,500,000 for road improvements on certain designated county roads. The agreement requires variable monthly payments for 240 months to be paid in full December 20, 2021. The principal balance of the agreement was \$1,299,642 as of June 30, 2005. Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2006	\$ 41,434	\$ 60,661
2007	39,433	62,662
2008	37,366	64,729
2009	35,029	66,865
2010	33,023	68,970
2011-2015	129,402	381,171
2016-2020	62,265	448,211
2021-2022	4,073	146,373
Totals	<u>\$ 382,025</u>	<u>\$ 1,299,642</u>

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 5. Long-term Debt (Continued)

- C. On April 19, 2002, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$2,260,000 for the building of a new library. The agreement requires variable monthly payments for 240 months to be paid in full January 20, 2021. The principal balance of the agreement was \$1,903,802 as of June 30, 2005. Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2006	\$ 88,336	\$ 76,301
2007	84,796	80,598
2008	81,056	85,135
2009	77,106	89,926
2010	72,934	94,985
2011-2015	282,813	566,815
2016-2020	98,271	728,569
2021	7,966	181,473
Totals	<u>\$ 793,278</u>	<u>\$ 1,903,802</u>

- D. On January 14, 2003, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$83,000 for the purchase of vehicles for the sheriff's department. The agreement requires variable monthly payments for 60 months to be paid in full February 20, 2007. The principal balance of the agreement was \$43,000 as of June 30, 2005. Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2006	\$ 891	\$ 21,000
2007	334	22,000
Totals	<u>\$ 1,225</u>	<u>\$ 43,000</u>

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 5. Long-term Debt (Continued)

- E. On April 28, 2003, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$440,000 for the purchase of road equipment. The agreement requires variable monthly payments for 60 months to be paid in full May 20, 2011. The principal balance of the agreement was \$340,000 as of June 30, 2005. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest	Scheduled Principal
2006	\$ 9,937	\$ 52,000
2007	8,574	54,000
2008	6,656	56,000
2009	4,859	57,000
2010	3,047	59,000
2011	1,150	62,000
Totals	<u>\$ 34,223</u>	<u>\$ 340,000</u>

- F. On April 15, 2005, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$175,000 for the purchase of vehicles and mowing equipment. The agreement requires variable monthly payments for 48 months to be paid in full April 20, 2009. The principal balance of the agreement was \$171,600 as of June 30, 2005. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest	Scheduled Principal
2006	\$ 4,224	\$ 41,604
2007	3,036	42,982
2008	1,834	44,621
2009	587	42,393
Totals	<u>\$ 9,681</u>	<u>\$ 171,600</u>

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 5. Long-term Debt (Continued)

G. On April 8, 2005, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$76,839 for the Ambulance Service. The agreement requires variable monthly payments for 48 months to be paid in full April 20, 2009. This debt is not included as debt of the county because the Ambulance Service is required to make the monthly payments and has title to the ambulance. The principal balance of the agreement was \$73,805 as of June 30, 2005. Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2006	\$ 1,423	\$ 18,462
2007	1,016	19,012
2008	594	19,579
2009	169	16,752
Totals	<u>\$ 3,202</u>	<u>\$ 73,805</u>

H. Changes In Long-term Liabilities

Long-term liability activity for the year ended June 30, 2005, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Primary Government:					
<u>Governmental Activities:</u>					
Financing Obligations	<u>\$ 5,961,153</u>	<u>\$ 175,000</u>	<u>\$ 353,477</u>	<u>\$ 5,782,676</u>	<u>\$ 358,922</u>
Governmental Activities					
Long-term Liabilities	<u>\$ 5,961,153</u>	<u>\$ 175,000</u>	<u>\$ 353,477</u>	<u>\$ 5,782,676</u>	<u>\$ 358,922</u>

Note 6. Interest On Long-term Debt and Financing Obligations

Debt Service on the Statement of Activities includes \$ 226,230 in interest on financing obligations.

Note 7. Related Party Transactions

Tommy Phipps, the Morgan County Treasurer, also serves as treasurer for the Morgan County Ambulance Service, a sub-recipient of State Grant Funds. Mr. Phipps is also an employee of the depository where the County's cash and investments are held.

See Accompanying Auditors' Report.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 8. Employee Retirement System

The county has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing multiple-employer defined benefit plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5.0 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 8.48 percent. Hazardous covered employees are required to contribute 8.0 percent of their salary to the plan. The county's contribution rate for hazardous employees was 22.08 percent.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Aspects of benefits for hazardous employees include retirement after 20 years of service or age 55.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is present in the Kentucky Retirement Systems' annual financial report.

Note 9. Insurance

For the fiscal year ended June 30, 2005, Morgan County was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

See Accompanying Auditors' Report.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information – Modified Cash Basis
For The Year Ended June 30, 2005

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis

For The Year Ending June 30, 2005

	GENERAL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive Negative
	Original	Final		
REVENUES				
Taxes	\$ 453,100	\$ 548,363	\$ 553,040	\$ 4,677
In Lieu Tax Payments	26,500	26,500	28,042	1,542
Excess Fees	0	28,346	28,346	0
Intergovernmental	4,319,520	4,852,101	1,725,883	(3,126,218)
Miscellaneous	94,080	161,118	170,090	8,972
Interest	15,000	63,825	56,055	(7,770)
Total Revenues	\$ 4,908,200	\$ 5,680,253	\$ 2,561,456	(3,118,797)
EXPENDITURES				
General Government	\$ 556,179	\$ 660,143	\$ 574,023	\$ 86,120
Protection to Persons and Property	244,190	250,179	107,884	142,295
General Health and Sanitation	274,648	303,771	132,608	171,163
Social Services	500	500	0	500
Recreation and Culture	81,970	77,696	3,160	74,536
Roads	100,000	100,000	0	100,000
Debt Service	199,239	239,613	239,611	2
Capital Projects	4,464,971	4,694,178	1,537,441	3,156,737
Administration	329,447	345,223	294,823	50,400
Total Expenditures	\$ 6,251,144	\$ 6,671,303	\$ 2,889,550	\$ 3,781,753
Excess (Deficiency) of Revenues over Expenditures Before Transfers and Financing Sources (Uses)	\$ (1,342,944)	\$ (991,050)	\$ (328,094)	\$ 662,956
OTHER FINANCING SOURCES (USES)				
Financing Obligation Proceeds				
Transfers From Other Funds	\$ 0	\$ 0	\$ 91,109	\$ 91,109
Transfers To Other Funds	(130,939)	(130,939)	(130,000)	939
Total Other Financing Sources (Uses)	\$ (130,939)	\$ (130,939)	\$ (38,891)	92,048
Net Change in Fund Balances	\$ (1,473,883)	\$ (1,121,989)	\$ (366,985)	\$ 755,004
Fund Balances, Beginning	1,473,883	1,161,989	1,180,097	18,107
Fund Balances, Ending	\$ 0	\$ 40,000	\$ 813,112	\$ 773,111

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2005 (Continued)

	ROAD FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
In Lieu Tax Payments	\$ 13,500	\$ 13,500	\$ 13,392	\$ (108)
Intergovernmental Revenue	897,633	1,733,220	1,726,470	(6,750)
Charges for Services	0	117,500	117,500	0
Miscellaneous	8,000	23,873	23,136	(737)
Interest	8,000	8,000	3,810	(4,190)
Total Revenues	<u>\$ 927,133</u>	<u>\$ 1,896,093</u>	<u>\$ 1,884,308</u>	<u>\$ (11,785)</u>
EXPENDITURES				
Roads	\$ 554,750	\$ 1,183,137	\$ 1,133,779	\$ 49,358
Road Facilities	0	37,521	20,115	17,406
Capital Projects	0	260,464	260,464	0
Debt Service	359,244	374,682	340,097	34,585
Administration	212,139	259,796	182,411	77,385
Total Expenditures	<u>\$ 1,126,133</u>	<u>\$ 2,115,600</u>	<u>\$ 1,936,866</u>	<u>\$ 178,734</u>
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Financing Sources (Uses)	\$ (199,000)	\$ (219,507)	\$ (52,558)	\$ 166,949
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	\$ 49,000	\$ 49,000	\$ 52,121	\$ 3,121
Total Other Financing Sources (Uses)	<u>\$ 49,000</u>	<u>\$ 49,000</u>	<u>\$ 52,121</u>	<u>\$ 3,121</u>
Net Changes in Fund Balance	\$ (150,000)	\$ (170,507)	\$ (437)	\$ 170,070
Fund Balance - Beginning	150,000	170,507	170,507	0
Fund Balance - Ending	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 170,070</u>	<u>\$ 170,070</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2005 (Continued)

	JAIL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive Negative
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 39,100	\$ 48,783	\$ 46,261	\$ (2,522)
Charges for Services	35,000	45,334	45,334	0
Miscellaneous	100	255	255	0
Interest	100	100	93	(7)
Total Revenues	<u>\$ 74,300</u>	<u>\$ 94,472</u>	<u>\$ 91,943</u>	<u>\$ (2,529)</u>
EXPENDITURES				
Protection to Persons and Property	\$ 241,000	\$ 297,137	\$ 295,235	\$ 1,902
Administration	16,989	26,150	19,369	6,781
Total Expenditures	<u>\$ 257,989</u>	<u>\$ 323,287</u>	<u>\$ 314,604</u>	<u>\$ 8,683</u>
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Financing Sources (Uses)	\$ (183,689)	\$ (228,815)	\$ (222,661)	\$ 6,154
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	\$ 183,189	\$ 183,189	\$ 222,250	\$ 39,061
Total Other Financing Sources (Uses)	<u>\$ 183,189</u>	<u>\$ 183,189</u>	<u>\$ 222,250</u>	<u>\$ 39,061</u>
Net Changes in Fund Balance	\$ (500)	\$ (45,626)	\$ (411)	\$ 45,215
Fund Balance - Beginning	500	5,626	5,626	0
Fund Balance - Ending	<u>\$ 0</u>	<u>\$ (40,000)</u>	<u>\$ 5,215</u>	<u>\$ 45,215</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2005 (Continued)

LOCAL GOVERNMENTAL ECONOMIC ASSISTANCE (LGEA) FUND				
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 101,000	\$ 283,472	\$ 234,472	\$ (49,000)
Interest	250	1,008	1,008	0
Total Revenues	<u>\$ 101,250</u>	<u>\$ 284,480</u>	<u>\$ 235,480</u>	<u>\$ (49,000)</u>
EXPENDITURES				
Total Expenditures	<u>\$ 0</u>	<u>\$ 183,230</u>	<u>\$ 0</u>	<u>\$ 183,230</u>
	<u>\$ 0</u>	<u>\$ 183,230</u>	<u>\$ 0</u>	<u>\$ 183,230</u>
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Financing Sources (Uses)	\$ 101,250	\$ 101,250	\$ 235,480	\$ 134,230
OTHER FINANCING SOURCES (USES)				
Transfers To Other Funds	\$ (101,250)	\$ (101,250)	\$ (235,480)	\$ (134,230)
Transfers From Other Funds	0	0	0	0
Total Other Financing Sources (Uses)	<u>\$ (101,250)</u>	<u>\$ (101,250)</u>	<u>\$ (235,480)</u>	<u>\$ (134,230)</u>
Net Changes in Fund Balance	\$ 0	\$ 0	\$ 0	\$ 0
Fund Balance - Beginning	0	0	0	0
Fund Balance - Ending	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2005 (Continued)

FORESTRY FUND				
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 3,500	\$ 3,500	\$ 3,005	\$ (495)
Interest	20	20	14	(6)
Total Revenues	<u>\$ 3,520</u>	<u>\$ 3,520</u>	<u>\$ 3,019</u>	<u>\$ (501)</u>
EXPENDITURES				
Protection to Persons and Property	<u>\$ 3,520</u>	<u>\$ 3,651</u>	<u>\$ 3,149</u>	<u>\$ 502</u>
Total Expenditures	<u>\$ 3,520</u>	<u>\$ 3,651</u>	<u>\$ 3,149</u>	<u>\$ 502</u>
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Financing Sources (Uses)	\$ 0	\$ (131)	\$ (130)	\$ 1
OTHER FINANCING SOURCES (USES)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Changes in Fund Balance	\$ 0	\$ (131)	\$ (130)	\$ 1
Fund Balance - Beginning	<u>0</u>	<u>131</u>	<u>130</u>	<u>(1)</u>
Fund Balance - Ending	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2005

Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

2. Reconciliation of budgetary schedules to the statement of Revenues, Expenditures, and Changes in Fund Balance – Governmental Funds – Modified Cash Basis

	Other Financing Sources/(Uses)	Expenditures
Road Fund		
Budgetary Comparison Schedule	\$ 52,121	\$ 1,936,866
Capital Lease Proceeds	175,000	
Capital Outlay Associated With Capital Lease		152,190
Governmental Funds – Modified Cash Basis	<u>\$ 227,121</u>	<u>\$ 2,089,056</u>

**REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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Certified Public Accountants

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Brenda K. Morgan, CPA
Jody B. Franklin, CPA

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To the People of Kentucky
Honorable Ernie Fletcher, Governor
Robbie Rudolph, Secretary
Finance and Administration Cabinet
Honorable Tim Conley, Morgan County Judge/Executive
Members of the Morgan County Fiscal Court

Report On Internal Control Over Financial Reporting
And On Compliance And Other Matters Based On An Audit Of
Financial Statements Performed In Accordance With Government Auditing Standards

We have audited the financial statements of the governmental activities and each major fund of Morgan County, Kentucky, as of and for the year ended June 30, 2005, which collectively comprise the County's basic financial statements, as listed in the table of contents and have issued our report thereon dated September 16, 2005. Morgan County prepares its financial statements in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Morgan County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

Report On Internal Control Over Financial Reporting And On
Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

Compliance And Other Matters

As part of obtaining reasonable assurance about whether Morgan County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing opinions on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such opinions. The results of our tests disclosed no instances of material noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of management and the Governor's Office for Local Development and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

A handwritten signature in cursive script that reads "Morgan-Franklin, LLC". The signature is written in dark ink and is positioned above the printed name of the firm.

Morgan-Franklin, LLC

Audit fieldwork completed –
September 16, 2005

Appendix A

**CERTIFICATION OF COMPLIANCE –
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM**

MORGAN COUNTY FISCAL COURT

**For The Fiscal Year Ended
June 30, 2005**

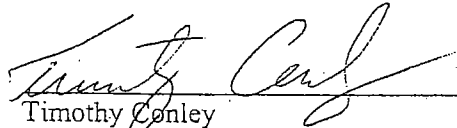
CERTIFICATION OF COMPLIANCE

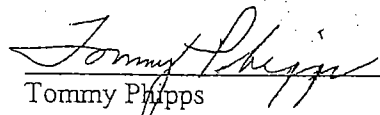
LOCAL GOVERNMENT ECONOMIC PROGRAM

MORGAN COUNTY FISCAL COURT

For The Year Ended June 30, 2005

The Morgan County Fiscal Court hereby certifies that assistance received from the Local Government Economic Assistance Program was expended for the purpose intended as dictated by the applicable Kentucky Revised Statutes.


Timothy Conley
County Judge/Executive


Tommy Phipps
County Treasurer